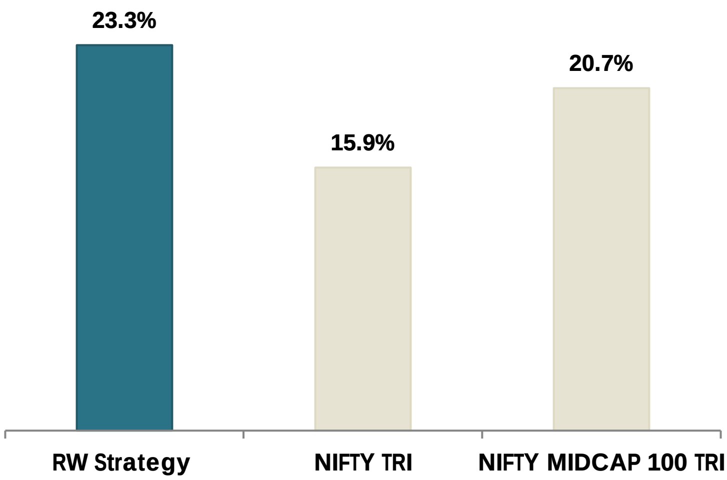
Quarterly Update — September 2021

Investment Objective

RW Investment Advisors uses a proprietary framework that combines fundamental and technical factors to identify businesses that can create long term wealth. The guiding philosophy is capital protection and compounding over longer periods.

Chart 1: RW Strategy TWRR (Since Inception)



Top Performers

Scrip Name	Purchase Date	Adj. Purchase Price (Rs.)	CMP (Rs.) as of 30-09-2021)	Growth (%)
KPITTECH	22-Sep-2020	111	342	208%
LAURUSLABS	05-Aug-2020	213	616	190%
SHAILY	07-Dec-2020	735	1,969	168%
BAJFINANCE	08-Jun-2020	2,950	7,668	160%
ASIANPAINT	01-Sep-2017	1,352	3,245	140%

Holding Companies

Asset Concentration	Holding
No. of Companies	33
Top 5 Company Holdings	25.4%
Top 10 Company Holdings	43.2%
Highest Exposure	BAJFINANCE (8.6%)

Sector Allocation

Sectors	Allocation (%)
BFSI	34.7%
Consumer	25.0%
Technology/Services	12.9%
Healthcare/Pharma	11.8%
Others	15.6%

Market Capitalization

Market Capitalization	Holding (%)
Large Cap	70.7%
Mid Cap	14.4%
Small Cap	14.9%
Avg. Market Cap (Rs. Bn)	1,961

Qualitative Analysis

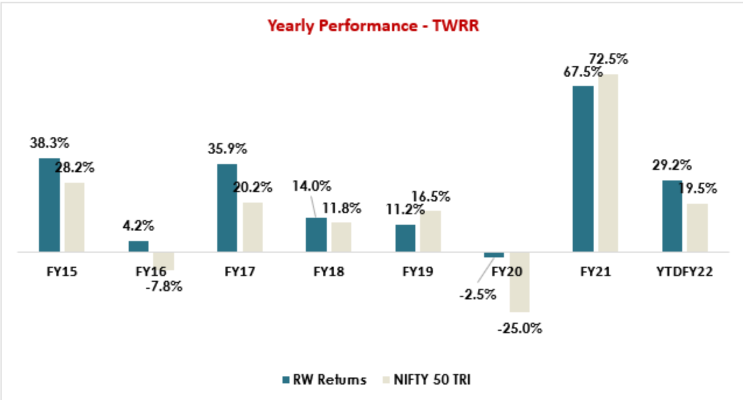
Parameters	TTM
PAT Growth	78.3%
PE	68.8x
ROE	18.84%

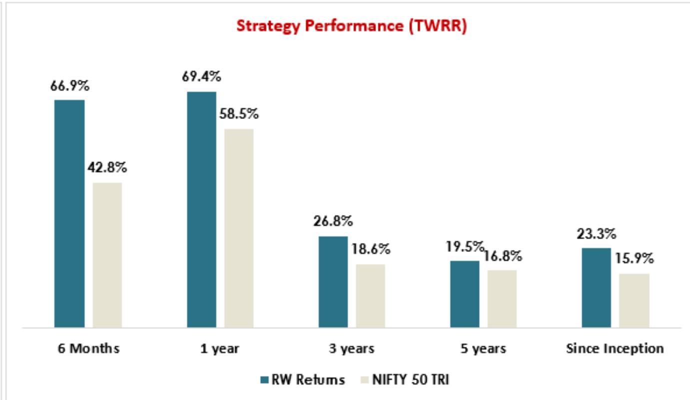
Holding Period

Holding Period	No. Of Scrips
Less than 1 Year	23
Between 1 to 3 Years	8
More than 3 Years	2

Disclaimers and Risk Factors

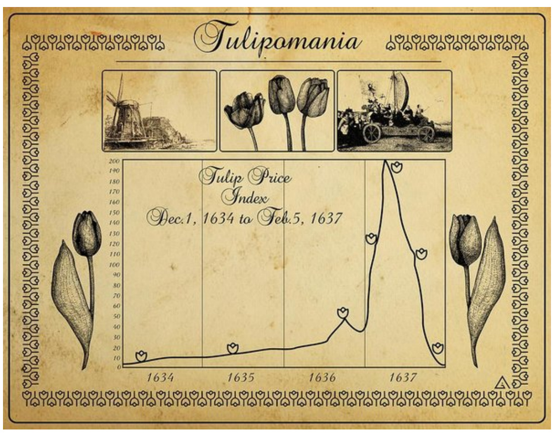
RW Strategy Inception Date: 17th December, 2013, Data as on 30th September, 2021. Data Source: RW Internal Research. RW Strategy results are for an actual Client as on 30th September, 2021. Returns of individual clients may differ depending on time of entry in the Strategy. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. The stocks forming part of the existing portfolio under RW Strategy may or may not be bought for new client. The Company names mentioned above is only for the purpose of explaining the concept and should not be construed as recommendations from RW Advisors. Strategy returns shown above are post fees and expenses.





YTDFY22 Data Annualized

With 23%+ compounded returns and about 7% alpha over Nifty 50, RW's performance has been more than satisfactory over the last 7.5 years. But, like the lower MTM numbers at the beginning of pandemic in April 2020, the rosy numbers now are fictitious, not just for us but for the entire industry. Long term absolute return expectations should be inline with earnings growth and in the portfolio of stocks that we hold, its about 18 to 20% and that is where returns should end up.



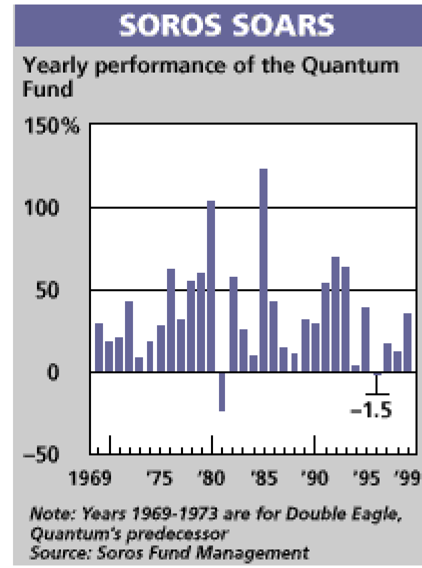
Every child and her puppy by now knows that easy money policies globally have led to asset bubbles in high growth, cash-burn tech stocks both in public and private markets. Recently, Latent view analytics IPO got subscribed an egregious 350 times and had one of the highest opening day gains. In this case, its not the quality of the company that worries us, it's the investor behavior.

High growth tech stocks in the US are finally experiencing gravity, as covid-induced excess tech spend is reducing and the Fed has started to taper as inflation continues to over shoot. It took all of two years to go to the moon and back for companies like Peloton, Vroom, Teladoc and other such hyper growth, 'burn' and crashers. Similarly, Indian tech stocks would not face an alternate reality, we just need more time and central bank tightening. Business models are far better this time around compared to 2000, but valuations should normalize.

In this newsletter, we examine the anatomy of bubbles and what defenses should investors build to protect from the losses, that occur in bubble wakes.

First the Bubble…

How the Soros Funds Lost Game Of Chicken Against Tech Stocks



As for Mr. Druckenmiller, "It would have been nice to go out on top, like Michael Jordan," he said at the news conference 10 days later. "But I overplayed my hand."

And Mr. Druckenmiller warmed to them. Attending Allen & Co.'s annual summit conference of corporate chieftains in Sun Valley, Idaho, last July, he heard a lot of talk about how technology was changing the whole economy. Soon the Soros funds were buying these stocks and selling short some Old Economy stocks. It worked: The Quantum Fund came all the way back to finish 1999 up 35%

By the end of April (2000), the Quantum Fund was down 22% since the start of the year, and the smaller Quota Fund was down 32%. Mr. Soros had stated in a 1995 autobiography that he was "up there" with the world's greatest money managers

Source: WSJ May 22, 2000

There can't be a better 30 year track record and a money manager pair than Druckenmiller and Soros in the history of investing. Quantum fund just had 2 down years and a staggering 30%+ compounded return over 30 long years. Yet, in the face of mob psychology and the incessant din of tech changing the world, they faltered. Ultimately, the Quantum Fund ended up down 22% in a quarter. A grim reminder of what greed and denial can do to best of the minds, retail investors would be like straw huts in a hurricane. So what led the Masters to be swayed that much?

1999 was like a wild orgy run by bankers, investors, VCs and retail investors alike, all feeding off each other's behavior. So much for utility curves being independent and concave. Nasdaq was up 85.6 percent in a year – that was the best ever performance put up by any index in a year in the history of stock markets. Stocks like Qualcomm went up 26 x in a year, just like that. 12 stocks in the Nasdaq index over $5 went up 10 x, another 7 stocks went up 9 x😊. A selection of an equal weighted 25 stocks over $ 5 bn market cap was up 4.5 x in a year in 1999 and another 20% in the march quarter of 2000 – same quarter in which the Quantum Fund lost 22%. In other words, 12 years of returns were cruched up in a single year – fundamentals became a joke and price was the only ultimate reality! That which we don't experience never feels real, but there are traces of this happening in our own backyard in names like Nykaa, Paytm and in the private space going by the number of unicorns that are being minted by the day, without real business models. It is therefore fair to assume that we will be suckered into investing in bubbles at some point, falling prey to narratives like network effects, new normal, Beamers for employees, disruptive tech et al.

… then the hangover:

Take this for post-party hangover –

- Only 30% of the companies from the 25 stock list above survived in the next decade
- Investment value of an equal weighted of those 25 stocks at the end of Dec-2000 has still not recovered 21 years later
- A Vanguard study showed that by the end of 2002, 70 percent of retirement accounts (401Ks) had lost at least one-fifth of their value; 45 percent had lost more than one-fifth.

Ultimately, the average investor ended up holding the bag when the bubble popped. It is in this context, that investors like us should have a framework to protect us from such ruins.

Three defenses for Investors:

1. **Best business models**: Even in the plethora of new age companies that are getting listed, look for companies with strong fundamentals i.e. a) strong engagement metrics determined by active users, repeat customers, pricing power b) industries with highest take rates or commissions eg. Policy Bazaar (insurance distribution) over PaisaBazaar (loan distribution) c) market leadership with high customer life-time value within a category d) most importantly, back only those companies with least cash burn and atleast 3 years of cash on books.

   On cash burn: In its prescient article on the companies that would survive the downturn in 2000, Barron's published an article called 'Burning Up' with the following key take aways:

   i. Of the 207 companies they examined, a quarter of companies had cash that would last less than a year and almost all of them did not survive
   ii. 74% of the 207 companies had negative cash flows
   iii. Even Amazon only had 10 months worth of cash as of Dec 1999, but they managed to raise convertible debt of $ 690 bn that gave an additional life line of additional 2 years. But for this fund raise, history would have been different
   iv. Price for such companies is currency, since there are no internal accruals – price becomes everything
   v. Funding dries up when you need it the most, like the convertible bond structures
   vi. Finally, VCs and Investors start looking for profitability rather than path to profitability, eventually

2. **Portfolio Positioning:**

   Amazon at the peak of 2000 was trading at EV/Sales of 8 to 10 x. Median EV/Sales for the 25 companies mentioned in the page above was 27. In comparison, Nykaa trades at EV/Sales of 46. No doubt, Nykaa has a great business model but trades at tulip valuations

   Even if investors are tempted to invest in these richly valued tech businesses, they'd be better off taking a portfolio approach, restricting the position size to 2.5% to 3% at max in each of these companies. Secondly, restrict the bubble part of the portfolio to 15 % of the book. We followed a similar play book coming out of the covid crisis, when we did not know which sectors would benefit on the other side of covid.

3 **Portfolio Exits**:

   i. The difference between Arjuna and Abhimanyu was that Arjuna knew how to come out of chakravyuha. Similarly, the most important thing for an investor in new age businesses is to have the exits right.
   ii. Based on Zweig's article "[D]uring the week of March 13, 2000, the absolute peak of the market bubble, 82% of finance chiefs said their shares were cheap, with only 3.4% saying their stock was overvalued". On the other hand, there were many sane minds starting from Shiller, Modigliani to JPM's chief strategists, there were a number of people who called the bubble, few too early, few too late.
   iii. So a common investor would be continuously squished between the uber optimistic crowd and sage advice from others. But with wild parabolic moves, price becomes the biggest determinant of behavior, completely detached from the fundamentals. For the macro-oriented investors, look for emerging signs of monetary and fiscal tightenting. Most bubbles pop as the policies tighten.
   iv. Based on Harold Vogel's book on Bubbles and Crashes, price volatility increases as the prices moves up, every drop during this ascension is lapped up by the crowds waiting on the sidelines. In such price driven manias, price itself becomes a true beacon. So it is critical to drown out the qualitative commentary, and exit at a high enough drawdown, without falling for the siren's song. **It is good to exit out of a position at a 25% fall from the peak or if the price cuts below a pre-determined short-term moving average.**

In Summary, even if you are tempted to invest in new age/ bubble companies:

- Invest in the best business models
- Restrict the exposure to 15 to 20% of the overall portfolio, don't take excess risk, restrict individual stock positions to 2.5-3%
- Exit individual exposures at 25% falls – don't stay too long at a party

Further Reading:

Book Recommendation: Financial Market Bubbles and Crashes Vogel, Harold L.

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in US$ mn				Long Term		Short Term	
Company	**Remark**	**Mcap in 2000**	**M Cap or Acq. Value**	**Investor Return**	**P/S 2000**	**Earlier Stock CY99**	**Returns 1Q CY00**
America Online	Acquired by Verizon Comm	179568	4400	-98%	23	96%	-5%
Juniper Networks		47696	10217	-79%	251	244%	171%
eBay		32363	46299	43%	83	56%	79%
CMGI	Steel Connect Inc.	30339	105	-100%	NA	940%	-17%
Exodus Comm	Bankrupt	28718		-100%	38	1006%	83%
Internet Capital Grp	Actua Corporation Liquidated (2018)	27106	32	-100%	NA	1291%	-40%
Amazon.com		23422	1814000	7645%	8	42%	-8%
Infospace.com		16068	877	-95%	183	1023%	56%
Broadvision	Acquired by Aurea Software	14914	22	-100%	69	1494%	11%
Priceline	Booking.com	13565	108744	702%	13	-31%	84%
DoubleClick	Search Ads 360.Acquired by google	12602	3100	-75%	26	1037%	-16%
Realnetworks		12208	66	-99%	54	571%	13%
Excite At Home Corp	Bankrupt	11922		-100%	16	16%	-20%
Phone.com	Merged with Software.com	11834	56	-100%	156	478%	48%
Intuit		11084	173658	1467%	11	148%	-7%
Portal Software	Acquired by Oracle	9983	220	-98%	75	175%	23%
TD Waterhouse Sec	Acquired by Ameritrade Holding Cor	8836	3300	-63%	7	-36%	42%
Red Hat Inc.	Acquired by IBM	7603	34000	347%	176	306%	-53%
E*Trade	Acquired by Morgan Stanley (2020)	7212	13000	80%	9	123%	18%
Lycos Inc	Acquired by Terra	6992	12500	79%	21	186%	-13%
VerticalNet	Acquired by Bravo Solutions	6454	15200	136%	52	623%	11%
FreeMarkets Inc.	Acquired by Ariba	6271	493	-92%	128	22%	-48%
Kana Comm Inc.	Acquired by Verint	6008	514	-91%	181	298%	2%
Entrust Tech.	Acquired by The Aldridge Company (2	5703			42	151%	73%

25 companies over $ 5 bn mcap from 2000, source: CS research